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NORSAT

ANNUAL REPORT 1997

A step ahead...values to move us forward

NII Norsat International Inc.

A step ahead...values to move us forward

Much like competitive athletes, our focus at Norsat is on striving to give our best performance and to remain a step ahead of our competitors. Our core corporate values — market position, creativity and quality relationships — keep us on a steady course, no matter what hurdles we encounter. These values move us forward as we negotiate the changing landscape and course alterations that are the reality of the dynamic global marketplace in which we compete.

NII Norsat International Inc. designs, engineers and distributes products for use in the satellite wireless communications and cable television industries. Norsat also distributes consumer satellite and home entertainment systems through its Aurora Distributing division in Canada and through its U.S. subsidiary, Diamond Pacific, Inc.

NII Norsat International Inc. is a publicly traded company listed on the Toronto Stock Exchange (symbol NII) and NASDAQ (symbol NSATF).

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Celebrating 15 years of pioneering satellite technology

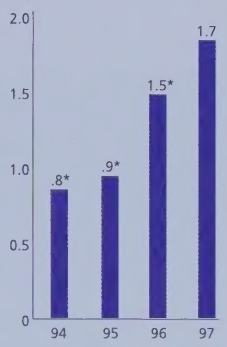
On October 15, 1997, Norsat proudly celebrated its 15 year anniversary. During this time, our organization has witnessed significant change and activity. Through the hard work and dedication of our team, Norsat has evolved from a local component supplier to an industry-leading satellite technology firm. We have scored impressive contracts and established a solid reputation worldwide for exceptional quality and service. It's a track record that we are extremely proud of, and one we look forward to building upon as we step confidently into the new millennium.

NORSAT®

Financial HIGHLIGHTS

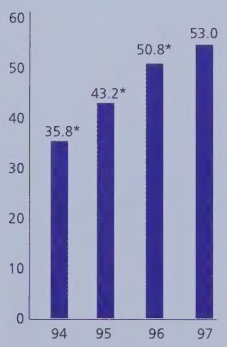
	1997	1996*	1995*	1994*
Financial summary (in thousands of Canadian dollars)				
Sales	**$ 52,952**	$ 50,843	$ 43,230	$ 35,822
Earnings before interest, taxes, depreciation and amortization	**2,998**	2,097	1,255	1,597
Net earnings (loss)	**(710)**	2,069	903	818
Cash generated by continuing operations (before changes in non-cash operating working capital)	**2,767**	2,388	1,311	1,412
Financial position (in thousands of Canadian dollars)				
Total assets	**$ 32,934**	$ 30,596	$ 27,333	$ 17,957
Long-term debt (excluding current portion)	**—**	81	84	3,021
Shareholders' equity	**20,669**	21,160	20,161	9,948
Ratio of debt to equity	**0.59:1**	0.45:1	0.36:1	0.81:1
Per common share (Canadian dollars)				
Net earnings (loss) – basic	**$ (0.04)**	$ 0.11	$ 0.05	$ 0.06
Cash generated by operations	**0.14**	0.12	0.07	0.10
Book value	**1.07**	1.07	1.02	0.66

** restated for discontinued operations adjustment*



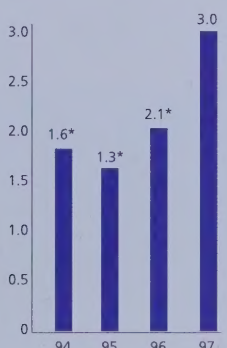
Operating Income – Pre-tax
in millions of dollars

* restated



Annual Sales
in millions of dollars

* restated



EBITDA
in millions of dollars

* restated

At A GLANCE

Business Overview

Commercial Products

Norsat's Commercial Products division supplies satellite and cable communications equipment for commercial applications. We are the world's leading supplier of C-band and Ku-band low noise block downconverters (LNBs) and are positioning ourselves to be the supplier of choice in the emerging higher-frequency Ka-band market for both receiving and transmitting components. In addition to the global sales team operating out of its Surrey head office, Norsat maintains sales and marketing facilities in the U.K., the U.S., China and Singapore, selling directly to customers and through a global network of partners and distributors. Operating our own manufacturing facility in Surrey strengthens Norsat's engineering leadership and contributes to the stringent control of quality, inventory, production costs, market response time and intellectual property.

Product Development

Norsat designs, develops and manufactures the highest quality products designed to meet the changing requirements of our marketplace. We have established a track record for designing and engineering high quality industry firsts and following up with the introduction of commercially viable versions for worldwide markets. Norsat is the world's number one supplier of LNBs, a position we will solidify with the introduction of several new designs during the current year. Our Ka-band DRO product has been fully tested and approved by outside sources and is now ready for production, and our new Ka-band PLL products are in the design phase. Significant research and development is underway to produce the next generation of our television audio/video signal decoder product, N-Code II. The recent acquisition of IMT Communications Systems Inc. adds significantly to our existing leading-edge research and development capabilities. For example, IMT has already developed a Ka-band transceiver for the very small aperture terminal market. We continue to explore potential strategic partnerships in the areas of product development and manufacture.

Distribution

Norsat distributes consumer satellite equipment and home entertainment products primarily to independent electronics and satellite TV retailers through its Aurora Distributing division in Canada and in the U.S. through its subsidiary, Diamond Pacific, Inc. (DPI). In addition, DPI distributes certain commercial products manufactured by Norsat and by Spaun Electric of Germany. Aurora Distributing, with nine branches across the country, is Canada's largest distributor of direct-to-home (DTH) satellite equipment. DPI currently has 11 branches in key centres across the U.S. and expects to establish 22 locations by the year 2000.

Strategic Direction

- *To be known as a world-class, multi-national communications company in each of our chosen markets.*
- *To be the first choice provider in each of our chosen market segments.*
- *To use new ideas, new applications and innovative problem solving to give our products and services unique advantages in our markets.*

1997 Highlights

- *Shipped $4 million worth of N-Code II television signal scrambling products to our partners in China.*
- *Identified new markets for N-Code II in South America and the Philippines.*
- *Created N-Code II sales and marketing groups for India, Eastern Europe and Taiwan.*
- *Established a product distribution channel in Southeast Asia by opening a new office in Singapore.*
- *Participated in a series of high profile marketing opportunities including the Asia Pacific Economic Cooperation (APEC) meeting in Vancouver, B.C.*

Norsat's state-of-the-art N-Code II scrambling system.

- *To partner with our customers and suppliers in a joint team approach to provide components, services and systems for communications solutions in the global marketplace.*

- *Introduced the world's first commercially-viable Ka-band LNB designed for high-speed, two-way communications networks.*
- *Enhanced our capability to produce made-to-order LNBs to customer specifications.*
- *Introduced redundant down-link system for commercial LNB applications, providing fail-safe back-up.*

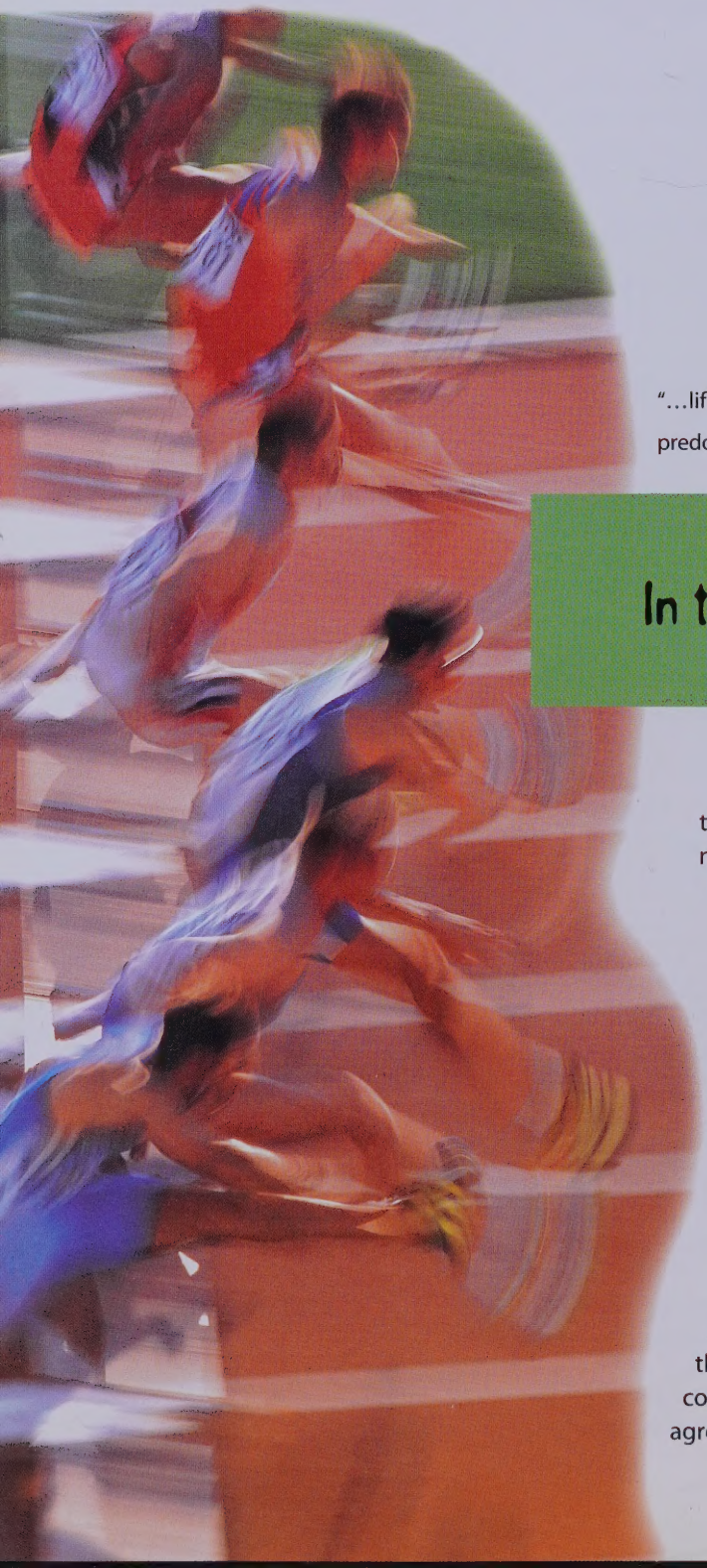
In 1997, Norsat introduced the world's first commercially viable Ka-band LNB.

- *To be the recognized experts in each of our markets.*
- *To establish and maintain quality relationships with all of our customers and suppliers.*
- *To select and offer products and services that meet current and emerging customer and market needs.*

- *DPI appointed by DirecTV® as a Master System Operator for the U.S. multiple dwelling unit market.*
- *DPI acquired distribution rights for General Instrument products.*
- *DPI branches opened in New York state, Kansas City and Dallas.*
- *A line of Star Choice-compatible DTH satellite TV receiving systems now available through Aurora Distributing.*
- *Aurora Distributing signed as exclusive Canadian distributor for Sherwood America.*

Norsat distributes a full range of consumer satellite and home entertainment products through DPI in the U.S., and Aurora Distributing in Canada.

To Our Shareholders



"...life is made up of sobs, sniffles, and smiles, with sniffles predominating."— O'Henry

In the race to be the best at what we

As Norsat's president on an interim basis, I have the privilege of writing this letter to its stockholders and the investing public in general. It is a privilege that I may not have the opportunity to repeat since, as my title implies, I am only temporary — a lame duck — while we search for a permanent president to lead Norsat into the new millennium. Unfortunately however, with that privilege comes the responsibility of reporting 1997 results which are disappointing to me, as president and a stockholder, and I am sure are equally disappointing to you. And although I consider myself an economical person, this letter will not economize on candor. No teeing up the ball in the rough. No calling line balls out. Just telling it like it is.

1997 was a struggle for Norsat. In July 1996, the Company became entangled in a web of litigation with lawyers as the spiders. Although Norsat had the assurances of its legal counsel that Aurora's distribution of the U.S. direct-to-home (DTH) satellite systems in Canada conformed with Canadian law, the Canadian courts did not agree, and that was the opinion that counted. So, before the

spiders could do further damage, Norsat decided it most prudent to settle the litigation in December 1997 and move on, in order to conserve management time and Company assets. Our decision resulted in a one-time write-off of $1.7 million. This write-off, when combined with the write down by $500,000 of our investment in Cyberion and the payments of taxes in the U.K., in turn resulted in a year-end loss, after taxes, of $710,366, or $0.04 per share.

As anyone who has been involved in litigation knows, the costs go far beyond out-of-pocket expenses. Management becomes distracted and critical business focus is deflected. By settling the court case, management was able to regain its focus and return vitality to the Company. After all, that is what you expect us to do. We concluded that Aurora could be redirected to distribute Canadian DTH in Canada. Our conclusions were correct because in January 1998, Norsat was appointed by Star Choice Communications to distribute the Canadian digital satellite system. Norsat now has renewed confidence that Aurora will return to its profitable way without costly legal distractions. So it was that Norsat's 1997 was made up of sobs, sniffles, and smiles.

ur corporate values and goals keep us on track.

Now let us turn to a few smiles. For the first three quarters of the fiscal year, Norsat posted record earnings based primarily on the success of our Commercial Products business. This division continued to make strides in expanding its customer base and tapping new markets for our high-quality satellite and cable communications products. Our growth in the commercial business was supported by the continued expansion of our U.S. distribution subsidiary, Diamond Pacific, Inc. (DPI), which aggressively extended its national presence and augmented its product line.

This momentum and our ability to meet financial projections was shattered in the fourth quarter by continued consumer uncertainty surrounding the Canadian DTH market and the litigation referred to above.

On the positive side, however, restated figures, adjusted for the necessary restructuring and prior to the one time write-offs, demonstrate that your Company continued to show improved growth and profitability. Sales increased to $53.0 million, from $50.8 million the previous year, while gross margins increased to $14 million or 26 per cent of sales, versus $11.3 million or 22 per cent of sales in 1996. Earnings before interest (income of $23,000), taxes ($224,000), depreciation ($691,000) and amortization ($590,000) — EBITDA — increased by 43 per cent to $3.0 million or 5.7 per cent of sales in 1997, compared to $2.1 million or 4.1 per cent of sales last year.

In 1997, our Commercial Products division maintained its dominant position in the expanding global low noise block downconverter (LNB) market. We remain the world's number one supplier of commercial LNBs, recognized for superior performance, durability and reliability. Our industry-leading position was strengthened by the recent acquisition of IMT Communications Systems Inc., a Canadian developer of LNB receiving systems and solid state power amplifier transmitting components. With the acquisition of IMT, Norsat adds $2 million to its research expenditures, and we are convinced that with IMT's engineering talent, Norsat will remain a leader in satellite reception and transmission.

Norsat shipped more than $4 million of our N-Code II signal scrambling components to China during the year. Successful demonstrations paved the way for initial orders now being received from large Chinese cable television operators. In addition to strengthening our position in Southeast Asia, our newly established marketing teams also targeted

sales opportunities in South America and India, regions where there is a significant need for systems that provide an economical solution to cable distribution, management and security challenges.

Diamond Pacific, Inc. (DPI) recorded an increase in sales of 33 per cent over the previous year and expanded its market share. These goals were achieved by opening three branch offices in strategic locations and adding desirable new products to an already extensive and appealing offering. For the year, DPI had a net profit before amortization of goodwill of $300,000. The comparison number for 1996 was $28,000. We are confident that during 1998 there will be more improvement especially as a result of DPI being appointed a DirecTV Master System Operator as referred to below.

With uncertainty arising from the domestic DTH situation and the outcome of litigation related to the sale of U.S. programming in Canada, the sales of our Canadian consumer equipment distributor, Aurora Distributing, decreased substantially in the fourth quarter, traditionally a strong sales period. We are pleased to note that Aurora's sales have since recovered and, in the early part of 1998, exceeded results during the same period last year. This rebound is partly due to Aurora's appointment in early 1998 as a distributor of Star Choice, a Canadian DTH service currently providing programming to an estimated 70,000 subscribers nationally.

Positioning Norsat for growth

I am confident in Norsat's growth potential and its ability to emerge as a major player in the global satellite industry, a business expected to post $29 billion in worldwide sales by the year 2000. This explosive growth is being driven by the growing demand for "instant communication" and the realization that a satellite-based network is no longer a "pie in the sky" vision, but a viable solution to overcoming barriers impeding the exchange of information between individuals and organizations whether they are located in far-flung villages or the streets of New York City.

Our industry-wide reputation for developing the highest quality LNBs, which play a key role in the effective operation of these networks, will ensure that Norsat retains its dominance in the commercial LNB market. This dominance is further enhanced by IMT's engineering and research skills. Our commitment to developing products that anticipate the evolving needs of a changing industry will also support the growth of our Commercial Products division.

We demonstrated this commitment in 1997 by introducing the world's first commercially-viable Ka-band LNB. The Norsat Ka-band LNB represents a significant technology breakthrough because it will be used in a wide range of high-speed, two-way digital communications networks — from satellite telephones and Internet access to distance learning, multimedia broadcasts, and voice and video conferencing.

The acquisition of IMT Communications Systems Inc. also strengthens our competitive position. IMT not only provides Norsat with new products for existing markets, but also supports our research and development capabilities. In particular, the acquisition adds Ka-band transmitter and transceiver products to our diverse and superior product line.

We continue to secure new international markets for our N-Code II system, particularly in China and South America. We expect to increase our market share by successfully demonstrating the superiority of our product line to large cable operators. As in the past, our success overseas will not be tied solely to the performance of our products. It will also be linked to the unique marketing strategy or "blueprint" designed to target new customers using knowledgeable sales teams that understand the local business environment, the language and customs.

Our projections for DPI in 1998 are aggressive. DPI will again expand its national presence by opening several new offices in key regions. It will also benefit from recent regulatory and operational changes within the U.S. satellite television industry. DirecTV® has eliminated its Sales Management Agent group, a block of distributors who because of a special financial ar-

rangement with the programmer could offer customers incentives for purchasing product. By eliminating this group, DirecTV has created a level playing field where customers must now purchase equipment from the company offering the best service and sales support. We are confident that DPI, with its Diamond Advantage service focus, will be the distributor of choice.

We are also targeting aggressive growth on the basis of a recent agreement that names DPI as an agent for DirecTV in providing programming to multiple dwelling units — apartments, condominium complexes — across the U.S. This market can be considered the last frontier of satellite television. Every person who lives in a multiple dwelling unit and desires DirecTV will ultimately have to obtain access through DPI or one of three other Master System Operators. DirecTV is spending almost $150 million in 1998 to advertise this service to the residents of an estimated seven million units.

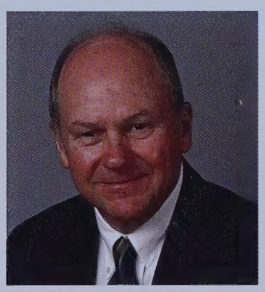
Aurora Distributing's outlook for the year is also positive. With the litigation now behind us, Aurora is focused on moving forward. We have adopted two strategies to support our growth and profitability. First, we have aligned ourselves with Star Choice, a Canadian DTH operator that we believe will emerge as the country's premier provider based on its sound business plan, solid financial position and extensive market penetration. Second, we plan to continue to diversify Aurora's core satellite business with products that complement its appealing offering. The first step toward meeting this objective was taken last year when Aurora was selected as the exclusive distributor of Sherwood audio products in Canada.

A values-driven organization

In 1997, we also set aside time for strategic planning and articulated our corporate vision and core values which set the theme for this year's annual report. Norsat is a values-driven organization and our employees demonstrate these fundamental beliefs in the way they work every day. Values are even more important when an organization faces challenge, because they ensure the focus remains on meeting business objectives.

I thank all of the staff at Norsat for their focus and dedication during this past year. We have had our difficulties, but through perseverance our employees have overcome these obstacles by working hard and applying Norsat's core values. I also acknowledge and thank our shareholders for their support and belief in Norsat's potential. I do not believe that support is misplaced. We have a covenant with our shareholders to manage the business as best we can. The market will ultimately decide if we are successful, because building shareholder value is the ultimate test and goal.

On behalf of the Board and all employees, let me assure you that we are committed to realizing this potential and earning your support. The appointment of a new permanent president and CEO, one who shares our passion for success and drive to achieve, is a critical priority. It is of paramount concern to me and the other Norsat employees working for you that there be smiles on all of our faces in 1998 and thereafter.



G. Bradford Cook
President and
Chief Executive Officer
June 1, 1998

A Dominant MARKET POSITION

We stay a s
under

We dedicate significant energy to understanding our markets. The markets in which Norsat has chosen to compete and where we are expanding our reach have been carefully selected to ensure the best return on investment. We continually evaluate and, where warranted, enter the race in new geographic areas and product sectors, both with respect to our commercial products and distribution businesses. We maintain close relationships with our customers; relationships which provide us with unique insights into market trends and the ability to lead — rather than follow — those trends.

Our ability to establish a dominant market position in new regions is linked to our unique marketing strategy. Everywhere we do business, we ensure that our employees are well versed in the culture, business customs and language of our current and potential customers. For most of our entries into foreign markets, our leading sales and technical staff are

supported by employees who have strong contacts with local manufacturers and distributors that we view as central to our success in these regions. This strategy is a blueprint for success we finetuned when approaching the cable market in China. When it makes economic and strategic sense, we also establish local offices and branches to better serve foreign markets, as has been the case in Southeast Asia and Europe.

The primary markets we address are those for satellite and terrestrial microwave components and for cable television signal scrambling systems, as well as the distribution of consumer satellite systems and related products.

requirements. When our customers told us that having the capacity to provide custom LNBs would put us "head and shoulders" above our competition, we responded. We can now supply many models of our LNBs on a made-to-order basis, both on short notice and in the various quantities required.

Our LNB customers also look to us to provide the product advancements they require to stay ahead of the competition. We have responded with a variety of new products for existing spectrum, as well as with commercially-viable LNBs for the Ka-band spectrum, a frequency reserved for a variety of high-speed, two-way digital communications services

head of the competition by gaining an intimate ling of the markets in which we operate.

Our commercial products market position is well established in North America and Europe and has been growing steadily in Southeast Asia. In 1997, we secured new commercial product markets in South America and the Philippines, established sales and marketing groups for our N-Code II cable television scrambling systems in India, Taiwan and Eastern Europe, and established a new Southeast Asian distribution presence by opening a centrally-located office in Singapore.

Norsat is the world's leading supplier of low noise block downconverters (LNBs) for commercial applications. An LNB, which is required by every satellite system regardless of its size or location, sits at the centre of a dish and converts incoming microwave signals into electrical signals that can be routed to a remote receiver. We are known for the unparalleled reliability of these products and for our ability to respond quickly and confidently to our customers' varying delivery

which address the global demand for faster access to the information superhighway.

Our recent acquisition of IMT Communications Systems Inc. strengthens our LNB product development capabilities, and permits us to meet customer needs for high-performance, high-reliability solid state power amplifiers and other transmission components.

Our N-Code II systems are recognized for the superior protection provided against pay TV and premium channel signal piracy. In North America, we are targeting major programming suppliers to encourage the cable system operators they supply to install our cost-effective N-Code II systems.

In early 1998, we were pleased to announce our first key sale of N-Code II in North America. Norsat has delivered an initial 350 set-top boxes to Setanta Network. Setanta has

A Dominant MARKET POSITION

installed these systems in sports bars and other establishments to allow for the reception of live Premier League soccer matches from Ireland. We anticipate additional sales as Setanta expects to build a large commercial subscriber base as it adds more European sports programming to its satellite delivery system throughout the U.S. and the Caribbean.

Outside of North America, we provide value to our cable TV customers in many ways. For the manufacturers/distributors and large cable system operators, we provide a cost-effective system which meets both their need for security and the need to recover and accurately decode signals transmitted through lower quality distribution networks. We also provide these customers with in-depth technical and manufacturing support through frequent on-site consultations and ready access to our engineering teams. To governments, we provide the willingness to partner with local companies for in-country manufacture of large portions of our N-Code II system, which not only benefits the local economy, but also solidifies our market position.

Our flexibility and ability to accommodate customer requirements was highlighted in a Global television feature broadcast in Canada during the high-profile Asia Pacific Economic Cooperation (APEC) summit, which was held in Vancouver, B.C. in November 1997. The story underscored Norsat's success in establishing itself as a leader in promising new regions and identified the Company as, "a model of what APEC is supposed to be about — more products and more jobs... building trade links and economic cooperation."

Our television and satellite consumer electronics retailer customers look to us primarily for high service levels at reasonable costs. Both in Canada, through Aurora Distributing, and in the United States, through Diamond Pacific, Inc. (DPI), we meet the needs of our customers by capitalizing on the significant purchasing power and the solid direct-to-home (DTH) service provider relationships afforded by our size.

Through our branch offices we provide dealer support, including promotions, rebate programs and product knowledge training. Our regional warehouses carry both products and parts, which allows us to respond quickly to orders and provide timely warranty support. We work closely with our dealers to ensure that our product selection is tailored to local preferences. The opportunities we provide retailers for direct feedback about products and end-user requirements help us strengthen our position in these markets. We also provide consumer financing; DPI is the only U.S. distributor to offer consumer financing nationally for C-band DTH satellite products.

We demonstrate our commitment to winning the race wherever we do business — by identifying the right markets, establishing the appropriate time to enter those markets and most importantly, by developing solid relationships with key manufacturing partners and retailers.

Reaching high to maintain our industry-leading reputation

Norsat has established itself as the number one supplier of commercial satellite receivers called low noise block down-converters (LNBs). It is a reputation we have earned over the past decade and a half by introducing a series of LNBs recognized for superior performance, durability and reliability.

Anyone unfamiliar with LNBs may find it hard to get excited by our reputation and the potential it represents. But consider this, every satellite terminal or dish uses an LNB to receive signals beamed from satellites in space. LNBs are a small, but key component in keeping communications networks working...today and in the future.

You may be surprised to know that you are exposed to LNB technology virtually every day. Most gas stations in North America, for example, rely on a satellite network to relay information to a central office. When you pump gas and use a credit card to complete the purchase, your payment is authorized and the station's fuel inventory is monitored via a satellite transmission.

And it's not only service stations that rely on satellite networks or Norsat LNBs. Many organizations use satellite networks to streamline their communications needs and in doing so, meet business objectives in an economical and efficient manner. Satellite networks are no longer about "pie in the sky" technology — but practical applications and real world solutions.

With the development of our Ka-band LNBs, Norsat is positioned to maintain its status as a dominant provider of specialized satellite technology. Future communications services are being launched in the higher frequency Ka-band spectrum which enables the use of faster transmission speeds and two-way, interactive applications. In the future, a Norsat Ka-band LNB mounted on a personal satellite dish will enable you to interact at satellite-speed with Internet content and digital programming.

Our commitment to product development, now strengthened with the acquisition of IMT Communications Systems Inc., ensures that our position as the number one supplier of commercial LNBs will remain unchanged.

Applying CREATIVITY

Our creative
we do business

Norsat is privileged to have some of the most creative and innovative people in the industry working on our cutting edge product solutions. We continually set ourselves apart by working closely with our customers to provide products that meet and anticipate their needs.

In the satellite microwave component sector, our principal customers are systems integrators who provide complete very small aperture terminal (VSAT) systems and receiving system packages to a growing base of international customers.

One way that we have historically been able to meet customer requirements for orders with short lead time, has been to maintain a significant inventory of product spanning a broad range of models and specifications. Now, however, we have developed the ability to deliver many models of our

low noise block downconverters (LNBs) on a made-to-order basis, reducing our inventory requirements, while improving our ability to meet customer demand.

In anticipation of future customer needs, we have engineered several modified versions of our LNBs to be introduced in 1998 and are continuing development of new consumer Ka-band LNBs for high-speed digital applications set for launch in late 1998 or 1999. The recent acquisition of IMT Communications Systems Inc. complements our ability to provide new Ka-band LNBs, as well as solid state power amplifiers (SSPAs) for use in VSATs. These are products that

modules which can be incorporated into locally-manufactured set-top boxes. Our engineering teams work closely with these customers to ensure that the design and manufacture of these units follow Norsat's precise specifications.

To meet future customer needs, we are in the final stages of developing a new set-top box model that will allow cable system operators to select from a range of features at corresponding prices, giving them the best product solution within their budget constraints.

A third-generation version of our N-Code II system is in development, as is system management software that will

f technology and innovative approach to the way helped us make our mark in the global marketplace.

will be increasingly required by our customers as two-way broadband wireless applications become increasingly available. This acquisition also enhances our ability to address the technical needs of our traditional Ku-band and C-band LNB customers.

In the cable TV sector, our principal customers are suppliers who manufacture and distribute components and systems to cable TV operators, as well as larger cable TV system operators. Our customers outside North America have specific needs, including the ability to introduce reliable signal scrambling systems quickly, while meeting government requirements for local manufacturing.

We make creative use of our existing N-Code II technology to respond to our customers' needs by providing either complete set-top box decoders or pre-constructed decoder

enable cable operators to automate the set-up and administration of their subscriber base.

On the consumer distribution side of our business, our customers include dealers and consumer electronics retailers. Our dealers are currently positioning themselves to address the large multiple dwelling unit (MDU) market, in response to U.S. legislation passed in 1996 which requires that residents of multiple dwelling units be able to choose from a variety of video entertainment delivery methods, including satellite television.

Approximately one-third of the American population live in apartments, townhomes, dormitories, care homes, trailer parks or some other form of multiple dwelling unit. Over the years, we have gained expertise in satellite-sourced television distribution systems through development of our

Applying CREATIVITY

Channel•On•Demand system. We are now combining that knowledge with the national reputation and reach of our distribution businesses to provide our dealers with a complete MDU solution that balances performance and video viewing quality with affordability.

Our creative team has gone even further to ensure that we offer the highest performing MDU systems at the best possible price. In anticipation of our dealers' needs in competing with cable TV delivery systems, we have developed new surround-sound encoder technology that makes this feature available to subscribers at a reasonable cost.

Our employees also demonstrate creativity when it comes to solving our customers' day-to-day problems. Rather than being unusual, it is a matter of course for Norsat's committed staff to go the distance for a customer. Whether this involves identifying specially-modified LNBs or rushing product to remote locations, our staff is flexible and willing to accommodate customer needs.

The creativity our employees demonstrate goes one step further in the worldwide marketing of our products and services. Recognizing the importance of timely, quality service delivery, we have applied new technologies to our product marketing initiatives enabling customers worldwide to access required information in a timely and convenient manner.

Central to these initiatives was the revision of our World Wide Web site **(www.norsat.com)**. In 1997, our in-house graphics and communications team redesigned and updated this site to include a vast array of detailed, technical product specifications. Customers now situated anywhere in the world can conveniently access detailed information on our industry-leading products and contact regional sales representatives for immediate follow-up. The establishment of our Web site and our commitment to its timely maintenance has truly enabled Norsat to open a storefront in the wired world.

Complementing our creative Web strategy, has been our commitment to tailoring our marketing initiatives to the tastes and cultures of our various customers. With the expertise and language capabilities of our multi-lingual staff, we are able to design advertisements and other high-profile marketing materials which appeal directly to customers in the various regions we target.

Norsat's creative and innovative approach to product development, business partnerships and marketing is key to our success and will ensure our continued growth in the global marketplace.

A creative sales approach hits the mark with N-Code II customers

Norsat's N-Code II technology is establishing itself as a dominant force in markets where cable operators face significant challenges relating to the distribution and security of programming, and the effective management of their subscriber base.

The N-Code II system, which was developed by Norsat's engineering team in consultation with its marketing staff, is a video scrambling system used in pay TV systems. It is comprised of two parts: the "headend" or major control units in cable facilities that scramble the channels delivered to subscribers and the "chips" inside the decoders that descramble signals delivered to viewers who have paid to receive programming. If a cable operator has installed Norsat's headend units, than it must also use the N-Code II technology to descramble the signals.

One of the key challenges facing cable providers today, particularly in the regions we are targeting, is piracy — the theft of programming. Billions of dollars are lost when pirates are able to "crack" a scrambling code and allow subscribers to receive channels without paying for them.

A chief feature of Norsat's N-Code II system is its ability to guard against piracy. As our technology is imbedded in a digital chip that cannot be copied, it is nearly impossible for TV viewers to receive programming without authorization from, and payment to, their cable operator.

N-Code II is superior to competitive brands not only because it eliminates piracy, but also as a result of our creative approach to sales and marketing. We can provide an extensive ready-for-installation system or work with customers to develop a solution that may incorporate their own technology. In addition, we speak the language of our customers and work hard to understand the unique demands of their business environment.

N-Code II has achieved a high level of success because we know that a good product doesn't sell itself. It takes hard work and a strategic marketing approach supported by the creative sales techniques of a dedicated team.

Quality RELATIONSHIPS

We consider our cus with them to er

We consider our customers and suppliers to be our partners in business. We look for relationships where cooperation can provide mutual benefit and for opportunities where a deeper knowledge of our customers and suppliers business' requirements will move us forward in the same direction.

When developing new products, we work closely with our key customers to ensure the final product design meets their requirements. We involve customers in prototype testing and in field tests to gather their valuable input. In return, we gain unequalled customer loyalty demonstrated by our early access to information about changing end-user requirements which we, in turn, can apply to product development, giving us a significant advantage in our market.

Our satellite microwave product customers appreciate our superior knowledge of the applications in which our products can be used, including low noise block down-

converters (LNBs) and, now, solid state power amplifiers and very small aperture terminal products.

We also have expert abilities when it comes to solving application challenges. Where customers LNB applications have required unique solutions, we have traditionally responded with a broad line of reliable, established products and the ability to rapidly modify those products to order.

We have developed the ability to manufacture our highly dependable LNBs to custom specifications in larger quantities, allowing us to anticipate and meet our customers unique specifications with even more speed and efficiency.

Our distribution businesses build strong dealer and supplier relationships, which in turn benefit the end-user. In both the U.S. and Canada, we have a national network of retailers. We provide significant training and incentives, and go out of our way to ensure constant two-way communication about customer preferences and retailer needs.

In the U.S., Diamond Pacific, Inc. (DPI), also offers the Diamond Point Program, a very aggressive and successful program that enables consumer electronics retailers to earn valuable points through the purchase of product. These points can then be used to obtain discounts on future purchases, applied

rs and suppliers to be part of our team and work closely we continue to move forward in the right direction.

We also seek a thorough knowledge of the underlying drivers of our customers' business. For example, with our N-Code II cable TV scrambling system customers, business drivers might include the need to halt signal piracy problems, while keeping system costs down. The need might also be for the most secure system available, while still allowing for local manufacturing. Regardless of the requirements, we ensure that we understand the reasons behind our customers' needs.

Where the situation requires hands-on assistance to customers who are integrating our proprietary components into their own set-top boxes, our engineering and manufacturing support teams are available to provide on-site or on-line help. In entering into close relationships, we take a long-range view. We do everything we can to ensure that our customers have the advantages necessary to compete successfully in their own markets.

towards the cost of product advertising, or used for both purposes if desired.

As a result of deep commitment to their retailer networks, both Aurora Distributing and DPI, have been chosen by major suppliers as distributors of choice, solidifying their leadership role in their respective markets and positioning them for continued growth and profitability.

Aurora has forged a strong alliance with Star Choice Communications, Canada's leading direct-to-home (DTH) satellite television supplier which currently maintains approximately 70,000 subscribers nationally. Aurora has also become the exclusive Canadian distributor for Sherwood America, an industry leader in premium performance home and mobile audio components.

In the United States, DPI was recently chosen by DirecTV® as one of only four companies to act as a Master

Quality RELATIONSHIPS

System Operator (MSO) in the rapidly growing U.S. multiple dwelling unit (MDU) direct-to-home satellite television market. DPI will provide programming, reception and distribution products, as well as expert technical support to MDU system installers nationwide. Our selection as an MDU is directly attributable to the strong personal relationship DPI cultivated with DirecTV.

It is not only our customers and suppliers with whom we aim to forge solid relationships. Over the past two years, Norsat has increased its commitment to strengthening its relationship with the financial community and the many shareholders who have supported our organization through periods of change and activity.

Recognizing the importance of maintaining regular dialogue with these audiences, Norsat has established a communications team focused on providing as much information as possible on the operations and achievements of our organization.

Over the past 12 months, this team has worked actively to strengthen its relationship with the investment community and facilitate access to timely corporate information. Key to this strategy was the establishment of a comprehensive investor Web site featuring a wide range of investor-relevant information such as a record of news releases, analyst reviews and up-to-date financial results. Another initiative involved the introduction of a toll free line which enables investors located throughout North America to easily obtain information.

Norsat remains committed to supporting its relationship with the investment community by maintaining its focus on information accessibility through new technologies like the Web. However, we also recognize the importance of "face-to-face" contact and plan to focus energy on strengthening our public information program.

Norsat is committed to building relationships with our customers, suppliers and shareholders; our investment of both time and resources in these areas reflect our view that it is key to our long-term success.

Quality relationships keep us in front of our competitors

Norsat continually attracts industry leaders as strategic business partners. A recently announced alliance demonstrates how we build relationships with other companies to create partnerships that benefit both parties.

Norsat's U.S. distribution subsidiary, Diamond Pacific, Inc. (DPI), was selected by DirecTV® as one of only four companies to act as a Master System Operator (MSO) for the delivery of DirecTV programming to multiple dwelling units (MDUs) across the United States. DirecTV, which currently has 3.4 million subscribers, is the largest and most successful provider of satellite programming in the U.S.

DPI's ability to secure this arrangement was supported by its access to the engineering knowledge and capabilities of its parent company, Norsat. No other U.S. distributor can boast the level of technical expertise that DPI has available through Norsat. It was also based on the strong personal relationship cultivated with DirecTV over a two year period.

Under the MSO agreement, which extends over five years, DPI will act as national agent for DirecTV to offer programming, and provide products and technical support to satellite contractors and dealers contracted to install direct-to-home (DTH) satellite receiving equipment and small network signal distribution equipment in MDUs.

The MDU market includes apartments, condominiums, townhouse complexes and other projects involving multiple units that cannot be readily served by individual DTH systems. DirecTV is investing approximately $150 million in 1998 to advertise this service to residents of an estimated seven million units.

DPI has already experienced initial success in providing equipment and technical support to a number of clients in this area, including the supply of satellite signal distribution equipment to Microsoft®.

Our commitment to creating and maintaining quality relationships with our customers and suppliers is a cornerstone to our long-term success in our selected markets.

Management's DISCUSSION & ANALYSIS

Results of operations

As the result of a one-time adjustment related to a settlement agreement with respect to discontinuing the sale of U.S.-based digital satellite systems and programming in Canada, Norsat reported a net loss of $710,366 in 1997, compared to net earnings of $2,069,490 in 1996.

After restating the figures for the discontinued operations, Norsat reported sales for the year ended December 31, 1997 of $52,951,681, up from $50,843,390 the previous year. Gross margin increased significantly to $14,002,964 or 26% of sales versus $11,348,053 or 22% of sales in 1996.

Earnings before interest, taxes, depreciation and amortization (EBITDA) increased to $2,998,252 in 1997, up 43% from $2,097,306 in 1996.

Key to this performance is Norsat's continued strength in the global satellite market in the Commercial Products division, which focuses on the worldwide sales of low noise block downconverters (LNBs). In addition, Norsat's U.S. distribution subsidiary, Diamond Pacific, Inc. (DPI), emerged as a major force in the U.S. as a provider of premium satellite products and services in both the consumer satellite market, and more recently in the Multiple Dwelling Unit (MDU) market.

Quality, performance and reliability are synonymous with the Commercial Products division record as the number one supplier of commercial LNBs worldwide. Sales in this area increased by 8% over the previous year's record performance. This industry-leading, position has enable Norsat to announce in 1997 the development and sale of the first commercially viable Ka-band LNB, a technology central to emerging communications networks. The recent acquisition of IMT Communications Systems Inc. further strengthens Norsat's Commercial Products division and positions it for continued growth by adding the development of a Ka-band transmitter and transceiver to the growing list of industry firsts.

The Commercial Products division state-of-the-art N-Code II scrambling and descrambling technology for the cable industry continued to strengthen in 1997, as shipments in excess of $4 million were completed during the year.

DPI recorded an increase in both sales and gross profit in 1997. With the addition of three new branches during the year and a steady growth in sales in the eight established branches, DPI's sales grew in excess of 33% over the previous year. DPI has now become a national distributor with offices coast to coast in the United States. Strategic marketing initiatives launched in 1996, highly trained personnel and its establishment as a national distributor resulted in DPI's appointment by DirecTV® as a Master Systems Operator (MSO) for the MDU market.

Norsat's Canadian consumer satellite equipment division, Aurora Distributing, experienced a significant reduction in sales in 1997, reporting a 28% decrease over the previous year. As Canadians made their choice, demand for U.S.-based digitial satellite systems declined significantly and Aurora's performance suffered accordingly. In December 1997, the Company reached a settlement agreement to discontinue the sale of U.S.-based digital satellite systems and programming in Canada. As part of the agreement, the Company discontinued the business operations of its programming divisions, disposed of the remaining assets, discharged its liabilities and incurred a one-time charge of $1,726,434 or $0.09 per share from discontinuing these operations. Subsequently, Aurora was appointed by Star Choice Communications Inc. to distribute the Canadian digital satellite system thereby providing Aurora with a new direction and a strong base from which to grow.

Operating expenses increased to $12,285,929 in 1997, compared to $10,167,415 in 1996. The components of the changes in these expenses were:

- Selling, general and administrative expenses increased to $10,483,697 in 1997, compared to $8,907,378 in 1996. This is due to the Company's increased sales and marketing expenditures in the Commercial Products division required to grow the worldwide sales of the N-Code II system. In addition, DPI's sales and marketing costs increased as a result of opening new branches during the year, and the completion of a full year of operation for new branches opened in 1996. Finally, administrative expenses remained relatively unchanged from the previous year as tight monetary policies have been maintained to control purchasing and expenses.
- Amortization of capital assets, goodwill and deferred costs increased to $1,281,217 in 1997, from $916,668 the previous year. This increase is a result of the amortization expense related to $1,424,262 of capital asset expenditures during the year. Capital asset expenditures were primarily for test and manufacturing equipment, such as the new surface mount equipment that was installed to facilitate the new LNB products currently under development. The amortization expense also relates to capital asset expenditures for computer equipment which are required to keep pace with changes in management information systems.
- Product development and engineering costs increased to $521,015, compared to $343,369 in 1996. This change is the result of a conscious decision by management to increase the amount invested in product development to enhance the Company's future technology prospects.

Bank charges and interest expense for 1997 was $391,904, an increase from $357,307 in 1996. The 1997 interest expense increased over 1996 due to a greater utilization of the bank line of credit to finance the growth in inventory that occurred with the addition of the new DPI branches. Earnings from continuing operations in the 1997 fiscal year were used to finance additions in capital assets and other investments.

Other income was $414,497 in 1997, compared to $648,043 in 1996, and represents revenue generated from investment of excess cash, to be employed to fund future business opportunities for Norsat's growth. The revenue declined as a result of the low rates of return realized on low risk investment instruments.

A write down of the investment in Cyberion Networking Corp. by $500,000 was made during the year and our interest in Cyberion is presently valued at $276,522, which represents management's best estimate of the net recoverable amount of its investment.

Income tax expense of $223,560 in 1997 is the result of the positive performance of the Company's subsidiary operations during the year.

Earnings from continuing operations were further reduced by the $500,000 Cyberion write down to $1,016,068 or $0.05 per share in 1997 compared to $1,471,374 or $0.07 per share in 1996. Earnings from continuing operations for 1997 before this write down and after income taxes were $1,516,068 or $0.08 per share.

After recording the one-time charge from discontinued operations of $1,726,434 , the net loss for the fiscal year 1997 was $710,366 with a basic loss per share of $0.04, compared to net earnings of $2,069,490 and basic earnings per share of $0.11 for the fiscal year 1996.

Liquidity and capital resources

Working capital decreased to $15,243,951 in 1997, down from $15,651,405 in 1996. This decrease was a relatively small amount considering the one-time adjustments recorded by the Company during the year. The Company remains in a strong working capital position with a very solid balance sheet to capitalize on new opportunities.

During the year ended December 31, 1997, the Company acquired 5,100 of its own shares pursuant to a normal course issuer bid for cash consideration of $9,110.

During the year the Company received $62,500 through the exercise of options to purchase 39,000 of its common shares. The Company currently reports 19,310,510 common shares as issued.

The Company has an operating line of credit in the form of overdrafts and letters of credit for a total of $4,000,000. The security for the credit facilities consists of a first security interest in all of the Company's personal property, assignment of insurance and inventory. These credit facilities bear interest at rates of 1/2% on guarantees and prime for operating loans.

The Company's U.S. subsidiary, DPI, has a revolving line of credit for U.S.$1,000,000. This line of credit is secured by the Company through a U.S. $1,000,000 standby letter of credit. The line of credit bears interest at the bank's reference rate, as publicly announced from time to time.

The year 2000

Management at Norsat has commenced the process of examining its computer systems to determine the impact of the year 2000 issue on the organization. The challenge revolves around the fact that many computer systems and software applications have been designed to recognize dates using only the last two digits of a year. It is anticipated that in the year 2000 many systems and programs may be interrupted or halted by this problem.

Based on a preliminary study, the Company expects to spend approximately $200,000 during the years 1998 and 1999 to modify its computer information systems enabling proper processing of transactions relating to the year 2000 and beyond. The Company continues to evaluate appropriate courses of corrective action, including replacement of certain systems whose associated costs would be recorded as assets and amortized. Accordingly, the Company does not expect the amounts required to be expensed over the next two years to have a material effect on its financial position or results of operations. The amount expensed in 1997 was immaterial.

Business prospects

Although 1997 was a difficult year for Norsat, management believes progress was made evidenced by improved results from earnings from continuing operations, by the settlement of the legal issue related to the sale of U.S.-based digital satellite systems in Canada, and by sustaining a strong working capital position. Norsat's strong working balance sheet provides excellent leverage to capitalize on new business opportunities in the global satellite industry and for the provision of funding required to sustain growth in its Commercial Products division, its U.S. distribution subsidiary and its Canadian consumer satellite equipment division.

Management's Responsibility

The consolidated financial statements have been prepared by management, which is responsible for the integrity and objectivity of this information. These statements have been prepared in conformity with generally accepted accounting principles and, where appropriate, include some amounts that are based on management's best estimates and judgements. The financial information presented elsewhere in this annual report is consistent with that in the consolidated financial statements.

A system of internal accounting and administrative controls is maintained by management in order to provide reasonable assurance that transactions are appropriately authorized, assets are safeguarded and financial records properly maintained to provide accurate and reliable financial statements.

The Board of Directors, through its Audit Committee, oversees management's responsibilities for financial reporting and internal control. The Audit Committee meets with management and the independent auditors to discuss auditing and financial matters and to review the consolidated financial statements and the independent auditors' report. The Audit Committee reports its findings to the Board for consideration in approving the financial statements for issuance to the shareholders.

The consolidated financial statements have been audited by KPMG, Chartered Accountants, who were appointed by the shareholders. The auditors' report outlines the scope of their examination and their opinion on the consolidated financial statements.

G. Bradford Cook
President and
Chief Executive Officer

Dale B. Belsher
Vice President, Finance and
Chief Financial Officer

Auditors' Report To The Shareholders

We have audited the consolidated balance sheets of NII Norsat International Inc. as at December 31, 1997 and 1996 and the consolidated statements of operations, retained earnings and changes in financial position for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 1997 and 1996 and the results of its operations and the changes in its financial position for the years then ended in accordance with generally accepted accounting principles. As required by the British Columbia Company Act, we report that, in our opinion, these principles have been applied on a consistent basis.

KPMG

Chartered Accountants
Surrey, Canada
March 25, 1998

Consolidated Balance Sheets

NII Norsat International Inc.

As at December 31,	1997	1996
Assets		
Current assets:		
Cash and cash equivalents	$ 9,273,506	$ 8,775,167
Accounts receivable (note 2)	6,540,693	6,341,508
Inventory (note 3)	11,539,954	9,712,828
Prepaid expenses	155,084	176,087
	27,509,237	25,005,590
Investments (note 4)	401,522	982,200
Capital assets (note 5)	3,037,798	2,423,511
Deferred costs, net of accumulated amortization (note 6)	690,782	134,328
Goodwill, net of accumulated amortization of $1,462,434 (1996 – $706,924)	1,294,452	2,049,962
	$ 32,933,791	$ 30,595,591
Liabilities and Shareholders' Equity		
Current liabilities:		
Bank indebtedness (note 7)	$ 5,400,658	$ 3,850,115
Accounts payable and accrued liabilities	6,788,628	5,500,962
Current portion of long-term debt (note 8)	76,000	3,108
	12,265,286	9,354,185
Long-term debt (note 8)	—	81,070
Shareholders' equity:		
Share capital (note 9)	20,049,532	19,537,882
Retained earnings	430,914	1,599,540
Cumulative translation adjustment	188,059	22,914
	20,668,505	21,160,336
	$ 32,933,791	$ 30,595,591

Commitments (note 13)
Contingency (note 17)
Subsequent event (note 18)

See accompanying notes to Consolidated Financial Statements.

On behalf of the Board:

Director

Director

Consolidated Statements Of Operations

NII Norsat International Inc.

Years ended December 31,	1997	1996
Sales	$ 52,951,681	$ 50,843,390
Cost of sales	38,948,717	39,495,337
	14,002,964	11,348,053
Expenses:		
Selling, general and administrative	10,483,697	8,907,378
Amortization of capital assets, goodwill and deferred costs	1,281,217	916,668
Product development	521,015	343,369
	12,285,929	10,167,415
Earnings from continuing operations, before other income (expenses) and income taxes	1,717,035	1,180,638
Other income (expenses):		
Bank charges and interest	(391,904)	(357,307)
Other income	414,497	648,043
Write down of investment	(500,000)	—
	(477,407)	290,736
Earnings from continuing operations, before income taxes	1,239,628	1,471,374
Income taxes - current (note 10)	223,560	—
Earnings from continuing operations	1,016,068	1,471,374
Earnings (loss) from discontinued operations, net of income taxes (note 11)	(1,726,434)	598,116
Net earnings (loss)	$ (710,366)	$ 2,069,490
Net earnings from continuing operations per share:		
Basic	$ 0.05	$ 0.07
Fully diluted	0.05	0.07
Net earnings (loss) per share:		
Basic	$ (0.04)	$ 0.11
Fully diluted	(0.04)	0.11

See accompanying notes to Consolidated Financial Statements.

Consolidated Statements Of Retained Earnings

NII Norsat International Inc.

Years ended December 31,	1997	1996
Retained earnings (deficit), beginning of year:		
As previously reported	$ 1,599,540	$ (6,181,376)
Prior period adjustment (note 16)	—	(469,950)
Retained earnings (deficit), beginning of year, restated	1,599,540	(6,651,326)
Elimination of deficit prior to restatement (note 9(a))	—	6,181,376
Excess cost on share redemption and cancellation (note 9(c))	(458,260)	—
Net earnings (loss)	(710,366)	2,069,490
Retained earnings, end of year	$ 430,914	$ 1,599,540

See accompanying notes to Consolidated Financial Statements.

Consolidated Statements Of Changes In Financial Position

NII Norsat International Inc.

Years ended December 31,	1997	1996
Cash provided by (used for):		
Operations:		
Earnings from continuing operations	$ 1,016,068	$ 1,471,374
Items not involving cash:		
Amortization of capital assets, goodwill and deferred costs	1,281,217	916,668
Write down of investment	500,000	—
Gain on sale of investment	(30,578)	—
Changes in non-cash operating working capital	(717,642)	1,023,090
Cash generated by continuing operations	2,049,065	3,411,132
Earnings (loss) from discontinued operations	(1,726,434)	598,116
Items not involving cash:		
Amortization of capital assets	75,568	18,412
Write down of capital assets	89,991	—
Write down of goodwill	228,820	—
Cash generated by (used for) discontinued operations	(1,332,055)	616,528
Financing:		
Issue of common shares	62,500	19,657
Repurchase of common shares	(9,110)	(1,112,840)
Principal payments on long-term debt	(8,178)	(553,286)
	45,212	(1,646,469)
Investments:		
Purchase of capital assets	(1,424,262)	(572,171)
Increase in deferred costs	(165,890)	(83,714)
Increase in goodwill	—	(30,002)
Purchase of investment	(125,000)	—
Proceeds on sale of investment	236,256	—
Purchase of licensing agreement	(500,675)	—
	(1,979,571)	(685,887)
Increase in cumulative translation adjustment	165,145	22,914
Increase (decrease) in cash position	(1,052,204)	1,718,218
Cash position, beginning of year	4,925,052	3,206,834
Cash position, end of year	$ 3,872,848	$ 4,925,052

Cash position is defined as cash and cash equivalents less bank indebtedness.
See accompanying notes to Consolidated Financial Statements.

Notes To Consolidated Financial Statements

NII Norsat International Inc.

Years ended December 31, 1997 and 1996

The Company was incorporated October 15, 1982 under the laws of the Province of British Columbia and commenced operations November 1, 1982. The Company operates in the satellite communication industry.

1. Significant accounting policies

(a) Principles of consolidation:

The consolidated financial statements are prepared in accordance with generally accepted accounting principles in Canada and include the accounts of the Company and all subsidiaries. All subsidiaries are wholly-owned.

(b) Cash and cash equivalents:

Securities with original maturities of three months or less when purchased are considered to be cash equivalents.

(c) Inventory:

Inventories of distribution products are stated at the lower of weighted average cost and net realizable value. Work in progress is stated at the lower of cost and net realizable value. Parts and supplies inventory is stated at the lower of cost and replacement cost.

(d) Investments:

The investment in Cyberion Networking Corp. was accounted for by the equity method when it held significant influence, being defined as an ownership interest in excess of 20%, and subsequently by the cost method. The investment in Pan Pacific Aviation Limited Partnership is accounted for by the cost method.

(e) Capital assets:

Capital assets are stated at cost. Amortization is provided using the following methods and annual rates which approximate the useful life of the assets:

Asset	Basis	Rate
Equipment	Straight-line	10-20%
Furniture and fixtures	Straight-line	10%

Leasehold improvements are amortized over the shorter of the term of the lease or their estimated useful life.

(f) Deferred costs:

Pre-operating branch start-up costs are amortized on a straight-line basis over a three year period from the date the branch commences operations.
The licensing agreement is stated at cost and amortized on a straight-line basis over the 3 year minimum term of the contract.

(g) Goodwill:

Goodwill is amortized on a straight-line basis over an eight to ten year period. Annual assessments are performed to determine the net recoverable amount and any resulting write down.

Notes To Consolidated Financial Statements

NII Norsat International Inc.

1. Significant accounting policies (continued)

(h) Foreign currency translation:

The Company translates its self-sustaining foreign operations using rates of exchange at the balance sheet dates for assets and liabilities and at average rates of exchange during the year for revenues and expenses. The resulting gains and losses are shown separately in the shareholders' equity section of the balance sheet.

(i) Earnings per share:

Basic earnings have been calculated based on the weighted average number of shares outstanding (net of shares held in treasury) during the year. Fully diluted earnings per share have been calculated based on basic earnings per share adjusted for the effect of the potential exercising of outstanding stock options.

(j) Use of estimates:

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant areas requiring the use of management estimates relate to the determination of net recoverable value of assets, useful lives for depreciation, amortization and provisions for contingencies. Actual amounts may ultimately differ from these estimates.

2. Accounts receivable

As at December 31,	1997	1996
Trade	$ 5,732,267	$ 5,555,529
Other	808,426	785,979
	$ 6,540,693	$ 6,341,508

Accounts receivable other includes interest free loans, totalling $294,000 (1996 - $416,000) due from a former officer of the Company and an advance to an officer of the Company totalling $75,000.

3. Inventory

As at December 31,	1997	1996
Distribution products	$ 10,322,283	$ 8,232,328
Work in progress	54,214	259,395
Parts and supplies	1,163,457	1,221,105
	$ 11,539,954	$ 9,712,828

4. Investments

As at December 31,	1997	1996
Cyberion Networking Corp.	$ 276,522	$ 982,200
Pan Pacific Aviation Limited Partnership	125,000	—
	$ 401,522	$ 982,200

(a) Cyberion Networking Corp. ("Cyberion")
At December 31, 1996, the Company owned 24% of Cyberion. During the year, the Company sold 525,000 shares of Cyberion for cash consideration of $236,256 resulting in a gain of $30,578 and reducing its ownership in Cyberion to 19%. Equity losses, related to the investment, were recorded up to the change in percentage ownership. The Company also wrote down the investment in Cyberion by $500,000 to represent management's best estimate of the net recoverable amount.
Subsequent to year end, the Company purchased a $200,000 convertible debenture in Cyberion. The principal amount is due on demand or can be converted, at the option of the Company, into common shares of Cyberion at a rate of Cdn. $0.2632 per share, up to a maximum of 760,000 shares. After the first anniversary of the debenture, the debenture is no longer convertible. Interest on the debenture is calculated at the bank's prime rate and payable semi-annually.

(b) Pan Pacific Aviation Limited Partnership (the "Partnership")
During 1997, the Company invested $125,000 in the Partnership. The Partnership's assets consist of demand notes and convertible preferred shares in a company controlled by an officer of the Company. The Company's investment has been secured by a specific charge against lands owned by the officer.

5. Capital assets

As at December 31, 1997	Cost	Accumulated amortization	Net book value
Equipment	$ 4,325,601	$ 2,304,479	$ 2,021,122
Furniture and fixtures	807,105	449,131	357,974
Leasehold improvements	846,652	558,209	288,443
Product development equipment	1,397,598	1,118,188	279,410
Leased equipment	338,950	248,101	90,849
	$ 7,715,906	$ 4,678,108	$ 3,037,798

As at December 31, 1996	Cost	Accumulated amortization	Net book value
Equipment	$ 3,465,498	$ 1,839,686	$ 1,625,812
Furniture and fixtures	714,308	396,317	317,991
Leasehold improvements	764,795	468,778	296,017
Product development equipment	1,141,348	1,078,148	63,200
Leased equipment	338,305	217,814	120,491
	$ 6,424,254	$ 4,000,743	$ 2,423,511

Notes To Consolidated Financial Statements

NII Norsat International Inc.

6. Deferred costs

As at December 31,	1997	1996
Pre-operating costs, net of accumulated amortization	$ 190,107	$ 134,328
Licensing agreement	500,675	—
	$ 690,782	$ 134,328

During 1997, the Company entered into a licensing agreement for cash consideration of $500,675. Beginning January 1, 1998, minimum annual royalties of U.S. $150,000 (Cdn. $215,000) are payable until December 31, 2000. Beginning January 1, 2001, annual minimum royalties become U.S. $300,000 (Cdn. $430,000). The Company has the option, exercisable on or before June 30, 2000, to purchase the licensed technology for U.S. $1,600,000 (Cdn. $2,289,000) and cease paying royalties. The Company is entitled to terminate the agreement upon six months notice after December 31, 1999.

7. Bank indebtedness

The Company has an operating line of credit of $4.0 million available in the form of overdrafts and letters of credit. The security for the credit facilities consists of a first security interest in all of the Company's personal property, subject only to the interests of the term loan (note 8), assignment of insurance and inventory. These credit facilities bear interest at rates ranging from 1/2% on guarantees to prime for operating loans.

The Company's subsidiary, Diamond Pacific, Inc. ("DPI"), has a revolving line of credit with a U.S. bank for U.S. $1,000,000. This line of credit is secured by the Company through a U.S. $1,000,000 standby letter of credit. The line of credit bears interest at the bank's reference rate, as publicly announced from time to time.

8. Long-term debt

As at December 31,	1997	1996
0% Subordinated debentures, due on June 30, 1998	$ 76,000	$ 76,000
Long-term obligations under capital leases	—	8,178
	76,000	84,178
Current portion of long-term debt	76,000	3,108
	$ —	$ 81,070

9. Share capital

The Company is authorized to issue 50,000,000 common shares without par value.

Common shares issued and fully paid:

	Number of Shares	Amount
Balance at December 31, 1995	19,736,405	$ 26,812,441
Elimination of deficit by paid-up capital reduction (note 9(a))	—	(6,181,376)
Upon exercise of options	17,005	19,657
	19,753,410	20,650,722
Shares purchased during the year and not cancelled (note 9(c))	—	(1,112,840)
Balance at December 31, 1996	19,753,410	19,537,882
Upon exercise of stock options	39,000	62,500
Shares cancelled during the year (note 9(c))	(481,900)	458,260
	19,310,510	20,058,642
Shares purchased during the year and not cancelled (note 9(f))	—	(9,110)
Balance at December 31, 1997	19,310,510	$ 20,049,532

At December 31, 1997, the Company held 5,100 (1996 - 481,900) common shares in treasury.

(a) At the Company's annual general meeting on May 29, 1996, the shareholders approved a $6,181,376 reduction in the share capital of the Company, with the corresponding elimination of the deficit of $6,181,376 at December 31, 1995 (prior to restatement).

(b) During the year ended December 31, 1996, the Company issued 17,005 common shares upon exercise of stock options granted.

(c) From June 18, 1996 to December 17, 1996, the Company acquired 481,900 of its own shares pursuant to a normal course issuer bid for cash consideration of $1,112,840. The purchase price exceeded the Company's average issue price by $458,260 which was charged to retained earnings during the year when the shares were cancelled.

(d) During the year ended December 31, 1996, the Company granted to certain of its officers and employees options entitling them to purchase up to 550,000 common shares of the Company. The options are exercisable at prices between $2.00 and $3.10 per share on or before various expiration dates ranging from January 23, 2001 to October 25, 2002.

(e) During the year ended December 31, 1997, the Company issued 39,000 common shares upon exercise of stock options granted.

Notes To Consolidated Financial Statements

NII Norsat International Inc.

9. Share capital (continued)

(f) During the year ended December 31, 1997, the Company acquired 5,100 of its own shares pursuant to a normal course issuer bid for cash consideration of $9,110.

(g) During the year ended December 31, 1997, the Company granted to an employee an option entitling him to purchase up to 20,000 common shares of the Company. The option is exercisable at $2.00 per share on or before January 17, 2002.

(h) At December 31, 1997, 1,189,295 (1996 - 1,423,295) stock options were outstanding. During 1997, 215,000 stock options expired or were cancelled without being exercised.

10. Income taxes

(a) Loss carryforwards and investment tax credits:

At December 31, 1997, the Company has a $275,000 (1996 - $1,450,000) non-capital loss available for carryforward to reduce future years' income for Canadian income tax purposes. The loss was incurred in 1992 and will expire in 1999. In addition, the Company has accumulated scientific research and development expenses that are available for indefinite carryforward as discretionary deductions of $6,600,000 (1996 - $6,135,000). The Company also has available $650,000 (1996 - $670,000) of net capital losses for an indefinite carryforward period to be applied against future capital gains. The tax effect of these carryforwards has not been recorded in the financial statements. In 1997, the Company applied $1,175,000 (1996 - $2,320,000) of the losses carried forward to extinguish the income tax liability.

Also, the Company has investment tax credits available to reduce taxes payable of $2,051,000. The investment tax credits expire as follows:

1998	$ 110,000
1999	260,000
2000	393,000
2001	297,000
2002	382,000
2003	193,000
2004	147,000
2005	98,000
2006	76,000
2007	95,000
	$ 2,051,000

Revenue Canada, Taxation is currently in the process of auditing the Company's investment tax credits available for carryforward and accordingly, the amounts noted above may be reduced subject to the outcome of the audit. Further, a portion of the scientific research and development expenses noted above having an indefinite carryforward period may be reduced with a corresponding increase in the amount of non-capital loss available for carryforward.

10. Income taxes (continued)

(b) Income tax expense:

The Company's income taxes and effective income tax rates pertaining to the operations were as follows:

	1997	1996
Earnings from continuing operations and before income taxes	$ 1,239,628	$ 1,471,374
Income tax expense	223,560	—
The income tax expense differs from the expected expense if Canadian statutory rates were applied to the earnings before income taxes. The principal factors causing these differences are shown below:		
Income tax expense at expected rate of 45.5%	564,000	670,000
Non-allowable (non-taxable) expenses or income	(12,400)	(1,000)
Prior period adjustment (note 16)	—	(107,000)
Recognition of benefits from previously unrecognized loss carryforwards, net	(528,000)	(681,000)
Timing differences, amortization, research and development costs, other, net	49,960	119,000
Timing differences, net capital losses	150,000	—
Income tax expense	$ 223,560	$ —

11. Discontinued operations

In December 1997, the Company adopted a formal plan to discontinue the business operations of its programming divisions and on December 17, 1997, it discontinued offering programming services to its customers. As part of its plan to discontinue these operations, the Company completed the disposition of remaining assets and discharged its liabilities by March 1998.

To December 17, 1997, the Company's programming divisions recorded operating income, net of income taxes of $56,229 (1996 - $598,116). To December 17, 1997, net revenues to the programming divisions were $6,770,906 (1996 - $6,650,231).

The following represents the remaining carrying values of assets and liabilities for the programming divisions at December 31, 1997:

Cash and cash equivalents	$ 292,000
Accounts receivable	536,000
Prepaid expenses	2,000
Capital assets	91,000
Accounts payable and accrued liabilities	(1,024,000)

Included in accounts payable and accrued liabilities are accrued disposition costs of $282,000.

12. Other information

(i) Geographic segments:

1997	Canada and other	United States	Consolidated
Sales to external customers	$ 35,659,166	$ 17,292,515	$ 52,951,681
Earnings from continuing operations, before other income (expenses) and income taxes	$ 1,972,103	$ (255,068)	$ 1,717,035
Identifiable assets	$ 25,324,516	$ 7,609,275	$ 32,933,791

1996	Canada and other	United States	Consolidated
Sales to external customers	$ 38,480,934	$ 12,362,456	$ 50,843,390
Earnings from continuing operations, before other income (expenses) and income taxes	$ 1,373,602	$ (192,964)	$ 1,180,638
Identifiable assets	$ 25,265,429	$ 5,330,162	$ 30,595,591

(ii) Export sales:

Revenue includes sales from the Canadian operations of the Company to geographic areas outside Canada for the fiscal years as follows:

	United States	United Kingdom & other countries
Fiscal 1997	$ 14,300,000	$ 6,100,000
Fiscal 1996	15,500,000	1,700,000

13. Commitments

Future minimum payments under various operating lease agreements by fiscal year at December 31, 1997 are approximately as follows:

1998	$ 758,000
1999	626,000
2000	226,000
2001	32,000
2002	21,000

14. Related party transactions

The following table summarizes the Company's related party transactions for the year:

	1997	1996
Revenue:		
Sales of product to Cyberion Networking Corp.	$ 37,000	$ 70,000
Management fees to Cyberion Networking Corp.	31,000	136,000

These transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

At the end of the year, the amount due from Cyberion, a related party, is $22,000 (1996 - $21,000).

The amounts due from Cyberion are due on demand and have arisen from the sales of services referred to above.

15. Financial instruments

(a) Fair value:

For certain of the Company's financial instruments, including cash equivalents, accounts receivable, investments, bank indebtedness and accounts payable and accrued liabilities, the carrying amounts approximate fair value due to their immediate or short-term maturity.

The fair values of obligation under long-term debt, calculated at the present value of future contractual payments of principal and interest, discounted at the current market rates of interest available to the Company for debt instruments with similar terms and maturity, approximate their carrying values and, therefore, no additional disclosure is necessary.

(b) Concentration of credit risk:

The Company revenues are dependent on customers in the satellite communication and home entertainment industries. As these customers are geographically dispersed, concentration of credit risk is considered to be minimal.

16. Prior period adjustment

As a result of an arbitration process through the International Chamber of Commerce, in July 1996 the Company and Teleport Europe GmbH ("Teleport Europe") came to an agreement regarding claims made against the Company for non-compliance with specifications in a product sales contract in 1993.

In exchange for the termination of legal proceedings by Teleport Europe, the Company agreed to deliver to Teleport Europe, free of charge, 500 satellite receiver units. In addition, Teleport Europe could acquire additional units at agreed upon prices per unit. The Company also committed to repair the satellite receivers delivered under the 1993 product sales contract, to a maximum of 200 units, at an agreed upon price per unit. All arbitration costs were shared equally by both parties.

As a result of this agreement, costs of approximately $470,000 associated with this claim, including legal fees, arbitration costs and the costs of producing and delivering the 500 units was recorded as a prior period adjustment to reflect the costs and liabilities associated with the sales contracts in 1993.

17. Contingency

In December 1997, the Company reached a settlement with the parties that had made claims against the Company in connection with the sale of U.S.-based digital satellite receiving/decoding systems in Canada. Costs of the settlement agreement have been included as part of discontinued operations. The Company may be required to perform additional acts in connection with the settlement agreement, the effects of which will be recorded as incurred.

18. Subsequent event

Subsequent to year end, the Company acquired IMT Communications Systems Inc. by exchanging 1,580,000 common shares of the Company fair valued at $2,543,800 for all of the issued and outstanding share capital of IMT Communications Systems Inc. The fair value of the shares is derived from their quoted market value at the date of acquisition less an adjustment to reflect quantities traded and price fluctuations.

Assets and liabilities acquired were as follows:

Assets acquired:		
Accounts receivable	$	482,876
Income taxes recoverable		413,438
Prepaid expenses		5,995
Capital assets		1,579,892
Goodwill		1,164,925
		3,647,126
Liabilities assumed:		
Bank indebtedness		(83,314)
Operating loan		(550,000)
Line of credit		(12,456)
Accounts payable and accrued liabilities		(259,813)
Deferred income tax payable		(80,900)
Long-term loan		(116,843)
Net assets acquired	$	2,543,800
Consideration given:		
Issue of common shares	$	2,543,800

19. Comparative figures

Certain comparative figures have been reclassified to conform with the financial statement presentation adopted for 1997.

Five Year Financial Summary

NII Norsat International Inc.

	1997	1996*	1995*	1994*	1993**
Operating results ($000)					
Sales	**52,952**	50,843	43,230	35,822	18,649
Earnings before interest, taxes, depreciation and amortization	**2,998**	2,097	1,255	1,597	298
Net earnings (loss)	**(710)**	2,069	903	818	(361)
Balance sheet ($000)					
Working capital	**15,244**	15,651	14,406	8,893	6,844
Capital assets – net	**3,038**	2,424	2,415	2,360	2,157
Total assets	**32,934**	30,596	27,333	17,957	13,359
Long-term debt (excluding current portion)	**—**	81	84	3,021	3,293
Shareholders' equity	**20,669**	21,160	20,161	9,948	6,147
Changes in financial position ($000)					
Cash generated by continuing operations (before changes in non-cash operating working capital)	**2,767**	2,388	1,311	1,412	344
Capital asset expenditures	**1,424**	572	558	514	347
Acquisitions of businesses	**—**	—	1,655	2,321	667
Equity issued	**63**	20	9,310	2,982	2,794
Per share ($)					
Net earnings (loss) – basic	**(0.04)**	0.11	0.05	0.06	(0.05)
Cash generated by operations	**0.14**	0.12	0.07	0.10	0.04
Book value	**1.07**	1.07	1.02	0.66	0.61
TSE/NASDAQ share price – high	**3.15**	4.00	6.00	2.34	2.27
– low	**1.50**	1.80	1.40	1.35	0.82
Financial ratios					
Current ratio	**2.24**	2.67	3.03	2.78	2.75
Inventory turnover (average)	**3.67**	5.45	5.88	5.46	3.89
Debt/equity	**0.59**	0.45	0.36	0.81	1.17
Net earnings (loss)/sales (%)	**(1%)**	4%	2%	2%	(2%)
Return on equity (%)	**N/A**	10%	6%	9%	N/A
Additional information					
R&D expenditures ($000)	**521**	343	347	533	656
Sales per employee ($000)	**363**	420	379	381	214
Shares outstanding (000)	**19,311**	19,753	19,736	15,022	10,140
Number of employees (average)	**146**	121	114	94	87

* *restated for discontinued operations adjustment*
** *restated for prior period adjustment*

Corporate INFORMATION

Directors

G. Bradford Cook
President & Chief Executive Officer

Ugo A. Doninelli
General Manager & Chief Executive Officer,
Prismafin S.A., Chiasso, Switzerland

Lindsay E. Ryerson
Vice President
General Manager, Aurora Distributing

Chris Theodoropoulos
Barrister and Solicitor

Officers

G. Bradford Cook
President & Chief Executive Officer

Dale B. Belsher
Vice President, Finance
Chief Financial Officer and Corporate Secretary

Donald D. Filmer
Vice President, Engineering

Patrick S.L. Mann
Vice President, Manufacturing

Wayne E. Meadows
Vice President, Commercial Products

Lindsay E. Ryerson
Vice President
General Manager, Aurora Distributing

Derick J. Walker
Vice President, Corporate Communications

Subsidiary Company Officers

Edward A. Johnson
President, Diamond Pacific, Inc.

Jim E. Nicholson
President, IMT Communications Systems Inc.

Transfer Agent

Montreal Trust
510 Burrard Street
Vancouver, British Columbia
Canada V6C 3B9

NII Norsat International Inc.

Head Office

12886 78th Avenue, Suite 302
Surrey, British Columbia
Canada V3W 8E7
Telephone: (604) 597-6200
Facsimile: (604) 597-6214
Internet: www.norsat.com
E-mail: info@norsat.com

US Sales Office

1720 Mineral Springs Road
Hoschton, Georgia
United States 30548-1605
Telephone: (770) 932-6810
Facsimile: (770) 932-6823
E-mail: norsat@ix.netcom.com

UK Sales Office

The Old School, South Carlton
Lincoln, United Kingdom LN1 2RL
Telephone: 011-44-1522-730-800
Facsimile: 011-44-1522-730-927
E-mail: norsat-uk@dial.pipex.com

China Sales Office

The Training Centre of Beijing
Beijing Broadcasting Institute
Ding Fu Zhuang Dong Street #1
Beijing, China 100024
Telephone: 011-86-10-65779852
Facsimile: 011-86-10-65755502
E-mail: norsat@public3.bta.net.cn

Singapore Office

126 Joo Seng Road #02-14
Gold Pine Industrial Building
Singapore 368355
Telephone: (65) 2896536
Facsimile: (65) 2866562
E-mail: asiacons@singnet.com.sg

IMT Communications Systems Inc.

5284 Still Creek Avenue
Burnaby, British Columbia V5C 4E4
Telephone: (604) 320-2641
Facsimile: (604) 294-5506

Aurora Distributing

Head Office

12886 78th Avenue, Suite 302
Surrey, B.C. V3W 8E7
Telephone: (604) 597-6290
Facsimile: (604) 597-6214

Alberta

14214 128th Avenue
Edmonton, Alberta T5L 3H5
Telephone: (403) 452-6890
Facsimile: (403) 455-7059

Saskatchewan

671 Park Street
Regina, Saskatchewan S4N 5N1
Telephone: (306) 721-4951
Facsimile: (306) 721-3380

Manitoba

2061 Logan Avenue, Suite 2
Winnipeg, Manitoba R2R 0J1
Telephone: (204) 633-6252
Facsimile: (204) 633-6254

Ontario

London
85 Midpark Road, Suite 6
London, Ontario N6N 2B1
Telephone: (519) 668-2777
Facsimile: (519) 668-3770

Mississauga
6200 Dixie Road, Suite 12
Mississauga, Ontario L5T 2E1
Telephone: (905) 564-1112
Facsimile: (905) 564-1333

Lindsay
188 St. David Street
Lindsay, Ontario K9V 4Z4
Telephone: (705) 324-9560
Facsimile: (705) 324-6559

Quebec

2486 Des Recollets Boulevard
Trois-Rivières, Quebec G8Z 3X7
Telephone: (819) 693-7313
Facsimile: (819) 693-7279

Nova Scotia

R.R. #2, Brookfield House #163
Shortt's Lake Road #1
Brentwood, Nova Scotia B0N 1C0
Telephone: (902) 673-3338
Facsimile: (902) 673-3358

Diamond Pacific, Inc.

Head Office

12886 78th Avenue, Suite 302
Surrey, British Columbia V3W 8E7
Telephone: (604) 597-6200
Facsimile: (604) 597-6214

Woodinville, Washington

12826 N.E. 178th Street, Suite C
Woodinville, Washington 98072
Telephone: (425) 486-1010
Facsimile: (425) 486-7978

Portland, Oregon

12839 NE Airport Way, Building 9
Portland, Oregon 97230
Telephone: (503) 253-3537
Facsimile: (503) 253-1690

Sacramento, California

5440 A Warehouse Way
Sacramento, California 95826
Telephone: (916) 387-6741
Facsimile: (916) 387-6748

Burbank, California

3086 North Lima Street
Burbank, California 91504
Telephone: (818) 842-1378
Facsimile: (818) 842-4167

Anaheim, California

1230 East Katella Avenue
Anaheim, California 92805
Telephone: (714) 978-7264
Facsimile: (714) 978-7896

San Diego, California

7370 Opportunity Road, Suite M
San Diego, California 92111
Telephone: (619) 278-8881
Facsimile: (619) 278-8999

Las Vegas, Nevada

Craig Commerce Center
2707 Craig Road, Suite J&K
N. Las Vegas, Nevada 89030
Telephone: (702) 642-4463
Facsimile: (702) 642-4468

Denver, Colorado

Stapleton East Business Center
12055 E. 49th Avenue, Unit C
Denver, Colorado 80239
Telephone: (303) 375-6512
Facsimile: (303) 375-6312

Kansas City, Missouri

4118 W. Riverside Drive
Riverside, Missouri 64150
Telephone: (816) 587-6655
Facsimile: (816) 587-6733

Dallas, Texas

1915 Peters Road, Suite 313
Irving, Texas 75061
Telephone: (972) 554-7565
Facsimile: (972) 554-7619

Houston, Texas

8570 Katy Freeway, Suite 112
Houston, Texas 77024
Telephone: (713) 465-0626
Facsimile: (713) 465-0375

Catskill, New York

140 Paul Saxe Road
Catskill, New York 12414
Telephone: (518) 678-9581
Facsimile: (518) 678-9586

*Current as at April 30, 1998

Investor Relations

Norsat is committed to providing the investing community with ongoing information about its financial results and operational achievements. If you would like to be placed on our paper or electronic mailing lists or if you require an update, please contact Derick Walker or Eduarda Hodgins:

Telephone:	(604) 597-6200
Toll free: (North America)	1-888-830-4223
E-mail:	info@norsat.com

Copies of news releases, newsletters and other pertinent information can be found on our Web site: www.norsat.com.

Annual General Meeting

NII Norsat International Inc.'s annual general meeting will be held on Thursday, June 18, 1998 at the Hyatt Regency Vancouver, Grouse Room, at 2:00 p.m.

Cautionary Statement Concerning Forward-looking Information

This document may contain certain forward-looking information and statements concerning the Company's operations, performance and financial condition, including, in particular, the likelihood of the Company's success in developing and expanding its business. These statements are based upon a number of assumptions and estimates that are inherently subject to significant uncertainties and contingencies, many of which are beyond the control of the Company. Actual results may differ materially from those expressed or implied by such forward-looking statements. Factors that could cause actual results to differ include, but are not limited to: Diamond Pacific, Inc.'s ability to open additional branches and the success of the multiple dwelling unit market in the U.S., the growth and acceptance of direct-to-home satellite systems in Canada, the ability of the Company to provide the resources required to expand the distribution of N-Code II, the expansion of satellite communications systems worldwide, the implementation of Ka-band satellite networks, and political and other risks associated with conducting business offshore.

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